IN THE

Supreme Court of the United States

October Term, 1975
No. 75-5371

Touche Ross & Co., *et al.*,

Petitioners,

vs.

Michael Fabrikant and Milton Binswanger,

Respondents.

Touche Ross & Co., *et al.*,

Petitioners,

vs.

Penn Mart Realty Co.,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Petitioners[1] respectfully pray that a writ of certiorari issue to review the order of the United States Court of Appeals for the Ninth Circuit, entered in these proceedings on May 19, 1975, which summarily dismissed Petitioners' appeal, taken pursuant to 28 U.S.C. Section 1291, of the class action certification order entered by the United States District Court for the Southern Dis-

[1]A complete list of Petitioners is set forth in the Appendix hereto at page A-1.

trict of California.[2] This dismissal denies Petitioners their right of appeal under Section 1291 and thereby creates a substantial prejudicial burden of defending these proceedings in a materially altered manner, as class actions, without the right of review of the District Court's order erroneously forcing these proceedings into the class action form.

Opinions Below.

The opinion of the United States Court of Appeals for the Ninth Circuit, not yet reported, appears in the Appendix hereto at page A-2. The opinion of the United States District Court for the Southern District of California is reported at 64 F.R.D. 443 and appears in the Appendix hereto at pages A-4 through A-26.

Jurisdiction.

The order of the United States Court of Appeals for the Ninth Circuit was entered on May 19, 1975. A timely petition for rehearing *en banc* was denied on July 9, 1973[3] and this petition for certiorari was filed within ninety days of that date. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

Question Presented.

Is a federal district court's order certifying a class action under Rule 23(b)(3) of the Federal Rules of Civil Procedure a "final decision" appealable as a matter of right under 28 U.S.C. Section 1291 in a complex action when such certification materially alters the manner in which that action must proceed?

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[2]The District Court refused to certify its order for interlocutory appeal under 28 U.S.C. §1292(b).

[3]The Ninth Circuit's order appears in the Appendix at page A-3.

Federal Statute and Rule Involved.

The statute involved is 28 U.S.C. Section 1291, which provides for jurisdiction of appeals of final decisions of federal district courts.[4]

The rule involved is Rule 23 of the Federal Rules of Civil Procedure, which in pertinent part provides the criteria for certification of class actions by federal district courts.[5]

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[4]United States Code, Title 28, Section 1291, provides as follows:

> "The courts of appeals shall have jurisdiction of appeals from all final decisions of the district courts of the United States, the United States District Court for the District of the Canal Zone, the District Court of Guam, and the District Court of the Virgin Islands, except where a direct review may be had in the Supreme Court."

[5]Federal Rules of Civil Procedure, Rule 23, in relevant part provides as follows:

Rule 23(a).

> "One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class."

Rule 23(b).

> "An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:
>
> * * * *
>
> "(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation

(This footnote is continued on next page)

Statement of the Case.

The order of the United States Court of Appeals for the Ninth Circuit which Petitioners seek to have reviewed by this Court involves three of the constituent actions comprising the proceedings designed as the U.S. Financial Securities Litigation. *In re U.S. Financial Securities Litigation* (J.P.M.L. 1974), 375 F.Supp. 1403. The three actions are *Penn Mart Realty Co. v. U.S. Financial Incorporated, et al.* (hereinafter referred to as *Penn Mart*), and two actions, both of which are denominated *Michael Fabrikant and Milton Binswanger v. Robert G. Stewart, et al.,* (hereinafter referred to collectively as *Fabrikant*).[6] Jurisdiction of the federal district courts was invoked in these actions because the purported causes of action arise under the federal securities laws.

The U.S. Financial Securities Litigation is an immensely complicated admixture of diverse individual civil actions, each of which presents complexities far beyond the ordinary. The plaintiffs in the various ac-

of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action."

Rule 23(c)(1).

"As soon as practicable after the commencement of an action brought as a class action, the court shall determine by order whether it is to be so maintained. An order under this subdivision may be conditional, and may be altered or amended before the decision on the merits."

[6]These actions, together with eleven others commenced in various federal district courts, were transferred pursuant to 28 U.S.C. Section 1407 to the United States District Court for the Southern District of California for consolidated or coordinated pretrial proceedings. The *Penn Mart* action is designated No. 74-281-T in the District Court and No. 74-3436 on appeal to the Ninth Circuit. The *Fabrikant* actions are designated Nos. 74-282-T and 74-283-T in the District Court and Nos. 74-3435 and 74-3437 on appeal. The multidistrict proceedings are designated MDL No. 161.

tions range from a few individuals to a large number of sophisticated investors such as banks, mutual funds, and pension plans. Each of the plaintiffs is alleged to be a purchaser of one or more of a variety of securities issued by U.S. Financial Incorporated or its corporate predecessor (both hereinafter referred to as USF).[7] In some of these actions the alleged securities transactions occurred in the open market; in others, the plaintiffs are alleged to have acquired the securities as a result of direct dealings with USF. In most of the actions a vast number of individuals and business entities, often totaling well over 100, are named as parties defendant.

The *Penn Mart* action is brought by an alleged open-market purchaser of USF common stock against 38 named defendants. The complaint alleges violations of Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder, by USF, its independent auditors, its directors and officers, several of its employees, and various other persons, in connection with the public trading of USF common stock. The violations of those provisions are said to consist of a series of vaguely defined, allegedly misleading statements during a 35-month period between January 1, 1970 and December 5, 1972.

The *Fabrikant* actions are brought by two purchasers of USF's 5½% convertible subordinated debentures, due April 1, 1991, against 121 named defendants. The

[7]USF, together with its numerous subsidiaries, was and is engaged in various real estate and related activities. On December 5, 1972, the Securities and Exchange Commission suspended trading in USF securities. On July 23, 1973, USF filed a petition seeking an arrangement under Chapter XI of the Bankruptcy Act and is presently seeking reorganization under Chapter X of the Bankruptcy Act in the United States District Court for the Southern District of California.

consolidated complaint alleges that these defendants, consisting of essentially the same persons named in the *Penn Mart* action with the addition of the 80 underwriters of the debentures, violated Sections 11 and 17 of the Securities Act of 1933, as well as Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder. This highly diverse group of defendants is alleged to have combined and conspired to disseminate, during a 20-month period between April 1, 1971, and December 5, 1972, a materially false registration statement and various other documents containing misleading statements.

Plaintiffs in the *Penn Mart* and *Fabrikant* actions moved pursuant to Rule 23(c)(1) of the Federal Rules of Civil Procedure for orders determining that the actions might proceed as class actions. Briefs were submitted on behalf of the plaintiffs and the defendants who are now Petitioners before this Court in both the United States District Court for the Southern District of New York prior to the Section 1407 transfer and in the United States District Court for the Southern District of California thereafter. Oral argument, however, was permitted only in the New York court; the California court denied the parties the opportunity to make oral presentations in spite of the fact that some of the defendants had not yet appeared at the time of the argument in New York.

On September 11, 1974, the United States District Court for the Southern District of California entered its order designating the *Penn Mart* and *Fabrikant* actions

as Rule 23(b)(3) class actions brought on behalf of the purported classes set forth in the order.[8] In the *Penn Mart* action the District Court held that the named plaintiff may act as the representative of all persons who purchased shares of USF common stock during the 35-month period in issue and who claim to have been injured by the wrongs alleged in the complaint. It is estimated that there are presently 4,000 shareholders and many thousands more former shareholders who are members of this purported class, each of whom is said to be asserting a claim against each of the 38 defendants arising from the series of alleged misstatements over the 35-month period. In the *Fabrikant* actions, the District Court held that the named plaintiffs may act as representatives of a class of all persons who purchased the USF debentures during the 20-month period in issue. This purported class may contain several thousand persons, each of whom is said to be asserting a claim against each of the 121 defendants based upon the alleged false registration statements and other allegedly misleading statements over the 20-month period. The damage claims to which defendants in these actions are exposed amount to many millions of dollars. In all three actions the District Court found that common questions of law and fact predominate by holding that the substantive securities fraud elements of reliance and duty may be proven with respect to an entire class instead of individually. The

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[8]The order appears in the Appendix at pages A-4 to A-26.

court failed to address itself to proof of the element of materiality.

On September 23, 1974, Petitioners moved in the District Court for certification of the court's order for immediate appeal pursuant to 28 U.S.C. Section 1292 (b). The court denied the motion on October 7, 1974.[9] Petitioners filed notice of appeal under 28 U.S.C. Section 1291 in each of the three actions and the Ninth Circuit consolidated the appeals by order dated February 7, 1975.

On December 12, 1974, Respondents moved to dismiss the appeals on the ground that the District Court's class action certification order was not a "final decision" within the meaning of Section 1291.[10] A two judge panel of the Ninth Circuit, by its order dated May 19, 1975, summarily dismissed the Section 1291 appeal.[11] It is to reverse this dismissal of the Section 1291 appeal that Petitioners seek review by this Court on certiorari.

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[9]In another U.S. Financial Securities Litigation case involving some of the identical issues, the same District Court recently granted a certificate for interlocutory appellate review under Section 1292(b) of a class action certification order. *Societe Generale de Banque v. Touche Ross Co.* (S.D. Cal. August 11, 1975) (No. 74-569-T), — F.R.D. —. The Ninth Circuit, however, on September 22, 1975, declined to take the *Societe* appeal.

[10]While this motion to dismiss was pending, and as a precautionary measure, Petitioners filed a petition for a writ of mandamus or prohibition and other relief in the Ninth Circuit based on the District Court's abuse of discretion in certifying the class actions under Rule 23 and in failing to certify the class action order for interlocutory appeal under Section 1292(b). This action was designated *Touche Ross and Co., et al. v. The Honorable Howard B. Turrentine*, No. 75-1496.

[11]Appendix at page A-2. This same order denies the petition for mandamus referred to in footnote 10 *supra.*

REASONS FOR GRANTING THE WRIT.

This petition raises the important and recurring question of when an appeal of right will lie under 28 U.S.C. Section 1291 from a federal district court's class action certification order issued pursuant to Rule 23 of the Federal Rules of Civil Procedure in complex actions such as those arising under the federal securities laws. This Court addressed itself to aspects of this question recently in *Eisen v. Carlisle and Jacquelin* (1974), 417 U.S. 156, 94 S.Ct. 2140, 40 L.Ed.2d 732 (*Eisen IV*), and appeared to hold that a class action certification order is a final decision, at least in the context of complex securities litigation, appealable as a matter of right under Section 1291. The Ninth Circuit's dismissal of the appeal in the present actions is either in direct conflict with *Eisen IV* or indicates that the question of the appealability of class action certification orders under Section 1291 is unsettled by *Eisen IV*. Further, the diverse, conflicting treatment afforded to this question by the decisions of other courts of appeals convincingly demonstrates that further guidance from this Court is critically needed. Absent such guidance, Petitioners, and other defendants in complex litigation such as the present actions, will be forced to suffer without recourse the significant additional risk, burden, and expense of maintaining their defenses under the pall of erroneous class action certifications which distort and impair their substantive rights.

1. The Decision of the Ninth Circuit Dismissing the Section 1291 Appeal of the Class Action Certification Order Conflicts With This Court's Decision in Eisen v. Carlisle & Jacquelin (Eisen IV).

In *Eisen IV,* this Court considered the question of appealability under 28 U.S.C. Section 1291 of a federal district court's orders certifying a class action and allocating the cost of notice, stating as follows:

> "At the outset we must decide *whether the Court of Appeals in Eisen III had jurisdiction to review the District Court's orders permitting the suit to proceed as a class action* and allocating the cost of notice. Petitioner contends that it did not. Respondents counter by asserting two independent bases for appellate jurisdiction: first; that *the orders in question constituted a 'final' decision within the meaning of 28 USC § 1291 [28 USCS § 1291] and were therefore appealable as of right under that section;* and, second, that the Court of Appeals in Eisen II expressly retained jurisdiction pending further development of a factual record on remand and that consequently no new jurisdictional basis was required for the decision in Eisen III. Because *we agree with the first ground asserted by respondents,* we have no occasion to consider the second." [Footnote omitted.] [Emphasis added.] 417 U.S. 156, 169-170, 94 S.Ct. 2140, 40 L.Ed.2d 732.

Although the context in which *Eisen IV* was decided suggests that the order allocating the cost of notice may have been the primary issue, the plain meaning of this language is that this Court considered the order certifying the class action, as well as the order allocating the cost of notice, to be a final decision within the meaning of Section 1291.

This conclusion is particularly compelled when the standard for finality under Section 1291, set forth in *Cohen v. Beneficial Loan Corp.* (1949), 337 U.S. 541, 69 S.Ct. 1221, 93 L.Ed. 1528, and readopted in *Eisen IV,* is considered in the context of complex securities law litigation. Under the *Cohen* standard, a decision is final if it

> ". . . appears to fall in that small class which finally determine claims of right separable from, and collateral to, rights asserted in the action, too important to be denied review and too independent of the cause itself to require that appellate consideration be deferred until the whole case is adjudicated," 337 U.S. 541, 546, 69 S.Ct. 1221, 93 L.Ed. 1528.

The standard is to be applied flexibly, as this Court recognized in *Eisen IV:*

> "We know, of course, that § 1291 does not limit appellate review to 'those final judgments which terminate an action . . .,' Cohen v. Beneficial Loan Corp., 337 US 541, 545, 93 L Ed 1528, 69 S. Ct 1221 (1949), but rather that the requirement of finality is to be given a 'practical rather than a technical construction.' Id., at 546, 93 L Ed 1528. The inquiry requires some evaluation of the competing considerations underlying all questions of finality—'the inconvenience and cost of piecemeal review on the one hand and the danger of denying justice by delay on the other.' Dickinson v. Petroleum Conversion Corp., 338 US 507, 511, 94 L Ed 299, 70 S Ct 322 (1950) (footnote omitted)." 417 U.S. 156, 170-71, 94 S.Ct. 2140, 40 L.Ed. 732.

It is readily apparent that under this flexible standard the failure to allow a Section 1291 appeal of an order certifying a class action in cases such as a complex securities law case imposes a great "danger of denying justice by delay." In all such cases, a class action certification order will have a major impact upon the risk and expense to the parties, the effort required in preparation for trial, and the course the litigation will take, regardless of whether a case would proceed absent class action status. Courts have often recognized that this impact inevitably manifests itself in enormous complications, delays, and expense to the defendants in conducting such actions, *Parkinson v. April Industries, Inc.* (2nd Cir. June 30, 1975), CCH Fed. Sec. L.Rep., Current Decisions ¶95,227, at 98,193-94, — F.2d —; *Eisen v. Carlisle and Jacquelin* (2nd Cir. 1973), 479 F.2d 1005, 1007 n.1 (*Eisen III*), *vacated on other grounds* (1974), 417 U.S. 156, 94 S.Ct. 2140, 40 L. Ed.2d 732 (*Eisen IV*); in the distortion of substantive rights to force the actions into the class action mold, *Parkinson, supra* at 98,193; *Kline v. Coldwell, Banker & Co.* (9th Cir. 1974), 508 F.2d 226, 238 (concurring opinion); *In re Hotel Telephone Charges* (9th Cir. 1974), 500 F.2d 86, 90; in the enormous coercive pressure brought upon defendants to settle such actions regardless of the merits, *Parkinson, supra,* at 98,193; *Herbst v. International Telephone and Telegraph Corp.* (2nd Cir. 1974), 495 F.2d 1308, 1313; and in the danger of preclusion of later effective appellate review of a certification order, either because most actions will be coerced to settlement or because appellate courts would be considerably more reluctant to overturn a class action certification after a district court and the parties have expended the time and effort to reach a final decision on the merits of the action, *Parkinson, supra* at 98,192; *Herbst, supra* at 1308.[12]

No case could provide a better illustration of the foregoing considerations than the present actions. The complexities created by thousands of plaintiffs alleging claims against hundreds of defendants arising from numerous unrelated statements made over lengthy time spans is self-evident. The coercive pressure to settle when the alleged damages run in the many millions of dollars is likewise obvious and it requires great courage to maintain even the soundest defense on the merits in the face of such potential liability.

Even more prejudicial is the willingness of the District Court to sweep aside Petitioners' substantive defenses on the merits to accommodate the procedural requirements for class actions under Rule 23.[13] Although conceding that the plaintiffs have not even alleged that the same or similar misrepresentations were made in the many statements in issue, the court embraces the "artificially inflated price" theory, which has not gained wide acceptance among the courts of appeals,[14]

[12]Courts have also recognized that there is a substantial burden placed upon federal district courts by class actions and that there are significant benefits to judicial administration in providing early appellate review of class action certification orders. By reviewing class action certification orders immediately under Section 1291, the courts of appeals can provide guidelines to the district courts for certification of class actions, can remove much of the uncertainty concerning the propriety of class action certification orders that now overshadows cases conducted under such orders, and can relieve the burden on the district courts, as well as the parties, of proceeding with improperly certified class actions. *E.g., Parkinson, supra* at 98,193; *Herbst, supra* at 1313.

[13]The District Court's order also ignores serious problems of manageability and of adequacy of the representative plaintiffs.

[14]In a very recent opinion, which has not yet become a final decision, the Ninth Circuit has apparently taken the po-

(This footnote is continued on next page)

as a substitute for individual proof of the element of reliance. Appendix at pages A-10 to A-15. Alternately, the court eliminates reliance by the nondisclosure theory, which it recognizes is not the gravamen of the complaint. Appendix at page A-15. Further, conceding that literally thousands of determinations of duty would be required by *White v. Abrams* (9th Cir. 1974), 495 F.2d 724, according to the character of each class member and the nature of his relationship to each defendant, the court simply rejects the applicability of this case,[15] since it would be "incongruous for *Abrams* to restrict the use of class actions. . . ." Appendix at pages A-16 and A-17.

What has occurred in the present actions, and what threatens to occur in other similar complex cases, is a modification of substantive rights to accommodate procedural considerations contrary to *Eisen IV* and 28 U.S.C. Section 2072, the Federal Rules Enabling Act, and a material alteration in the manner in which the actions must be defended, to the substantial prejudice of Petitioner. But what aggravates this prejudice

sition that in a case involving identical impersonal transactions on securities markets and a series of related misrepresentations the reliance element need not be proven by plaintiffs and that, instead, the causal nexus between plaintiffs' injuries and defendants' representations may be proven by the "artificially inflated price" theory. *Blackie v. Barrack* (9th Cir. September 25, 1975), Nos. 74-2141, 2341, 2167, 2466 and 2648. The complexities of fact and the unrelated statements involved in the present actions make application of this theory inappropriate.

[15]In *Blackie,* footnote 14 *supra,* the Ninth Circuit decided that *Abrams* does apply to class actions but that on the facts before it, including the very nature of the alleged misrepresentations, the duty may be the same with respect to identically situated plaintiffs who were purchasers in an impersonal market context. The complexities of fact and the nature of the alleged misrepresentations in the present actions render such a single determination of duty inappropriate.

most severely and what is in issue in the instant petition is the failure of the Ninth Circuit to grant Petitioners their right of appellate review at this stage of the litigation under Section 1291.[16] In spite of this Court's language in *Eisen IV* and in spite of the compelling reasons for granting immediate appellate review, the Ninth Circuit summarily dismissed the appeal in the present actions, apparently for lack of finality. This dismissal is contrary to *Eisen IV* and a denial of justice will occur in the present actions and in similar cases which may rely on the Ninth Circuit's position if this Court does not grant the writ and reverse the dismissal.

2. If Eisen IV Is Not Controlling, the Ninth Circuit's Dismissal of the Section 1291 Appeal of the Class Action Certification Order Raises an Important and Recurring Question of Federal Law Which Has Not Been Settled by This Court.

Petitioners' first contention, set forth *supra,* is that under this Court's decision in *Eisen IV* a federal dis-

[16]The appropriateness of appeal as a matter of right under Section 1291 is further mandated by the inequitable and inadequate protection afforded by certified appeal pursuant to 28 U.S.C. Section 1292(b) and by petition for mandamus pursuant to 28 U.S.C. Section 1651(a). *See, e.g., Herbst v. International Telephone and Telegraph Corp.* (2nd Cir. 1974), 485 F.2d 1308, 1313 n.9. The inadequate and inequitable nature of these discretionary remedies is readily apparent in the present actions. Both avenues of review were denied; yet in another U.S. Financial Securities Litigation case involving some of the identical issues, the same District Court recently granted a certificate for interlocutory appellate review under Section 1292(b) of its class action certification order. *Societe Generale de Banque v. Touche Ross & Co.* (S.D. Cal. August 11, 1975) (No. 74-569-T), — F.R.D. —. This complete reversal in *Societe* of the District Court's position taken in the present actions demonstrates the inequity of the remedy. The fact that the Ninth Circuit, by its order dated September 22, 1975, declined to take the appeal in *Societe* further demonstrates the inadequacy of the remedy.

trict court's order certifying a class action is appealable as a matter of right pursuant to 28 U.S.C. Section 1291, at least in complex securities law cases, and that, therefore, the Ninth Circuit's dismissal of the appeal in the present actions conflicts with *Eisen IV* and is in error. However, since the Ninth Circuit's order in the present actions and the decisions of other courts of appeals have dismissed Section 1291 appeals from class action certification orders in the face of *Eisen IV*, it may be that the question is still unsettled.

In spite of the plain language of *Eisen IV*, several subsequent decisions of courts of appeals have concluded from the context in which *Eisen IV* was decided that this Court reached only the issue of the appealability under Section 1291 of an order allocating the cost of notice in a class action, thus leaving unsettled the issue of appealability of an order certifying a class action. *See Williams v. Mumford* (D.C. Cir. 1975), 511 F.2d 363, 368-69 (petition for certiorari filed May 9, 1975, No. 74-1411); *Samuel v. University of Pittsburgh* (3rd Cir. 1974), 506 F.2d 355, 359; *General Motors Corp. v. City of New York* (2nd Cir. 1974), 501 F.2d 639, 646-47; *Parkinson v. April Industries, Inc.* (2nd Cir. June 30, 1975), CCH Fed. Sec. L. Rep., Current Decisions ¶98,190, at 98,195, — F.2d —. The Ninth Circuit's order in the present actions cites the *General Motors* case, suggesting that the Ninth Circuit also considers the question of the appealability of a class action order under Section 1291 to be unsettled by *Eisen IV*.[17] The confusing array of decisions of

[17]The Ninth Circuit has now rejected the test for appealability of class action certification orders under Section 1291 set forth by the Second Circuit in *General Motors*. *Blackie*, footnote 14 *supra*. However, the opinion in *Blackie* makes it apparent that

other courts of appeals, adopting a variety of standards for finality under Section 1291 in the class action context, further suggests the unresolved nature of the question.[18]

The importance of settling the question of appeal as a matter of right under Section 1291 cannot be denied. The impact that such an order has on both the parties and the district courts has been thoroughly demonstrated *supra* and is recognized by courts of appeals regardless of the standard of finality adopted.[19] There is always a detrimental burden on defendants in the material alteration of the manner in which they must defend such actions after a class action certification order and there is always a burden on the district courts in conducting such actions. Furthermore, the question is recurring nationwide, as is evidenced by the substantial number of recent courts of appeals decisions dealing with the question and by the fact that there are presently hundreds of class actions pending in the federal district courts. *E.g.*, *Herbst v. International Telephone and Telegraph Corp.* (2nd Cir. 1974), 495 F.2d 1308, 1312.

The present unsettled nature of this important and recurring question is intolerable and, as set forth *infra*, the several courts of appeals have not been able to arrive at a satisfactory and uniform resolution. This situation persists in spite of *Eisen IV*. Accordingly, it is essential that this Court grant the writ to elaborate on *Eisen IV* and to hold, for the reasons set forth *supra*, that class action certification orders in complex cases

the Ninth Circuit still does not consider *Eisen IV* to have settled the question. *See* the discussion in Part 3 *infra*.

[18]*See* the discussion in Part 3 *infra*.

[19]See the discussion *supra* at pages 12 to 14.

such as the present actions, which materially alter the manner in which such actions must proceed, are immediately appealable as a matter of right under Section 1291.

3. The Ninth Circuit's Decision Dismissing the Section 1291 Appeal Conflicts With the Decisions of Other Courts of Appeals Concerning the Appealability of Class Action Certification Orders.

In spite of this Court's decision in *Eisen IV*, emphasizing the flexible nature of the finality determination under Section 1291, the Ninth Circuit cited as authority for its dismissal of the instant appeal the Second Circuit's decision in *General Motors Corp. v. City of New York* (2nd Cir. 1974), 501 F.2d 639, in which a very strict three-prong test for appealability under Section 1291 is applied. Under this test, in order for a class action certification order to be appealable, it must be shown that the class action determination is fundamental to the further conduct of the case, that review of the order is separable from the merits, and that the order will cause irreparable harm to the defendant in terms of time and money spent in defending the class action. *Parkinson v. April Industries, Inc.* (2nd Cir. June 30, 1975), CCH Fed. Sec. L.Rep., Current Decisions ¶95,227 at 98,195, — F.2d —; *General Motors Corp. v. City of New York, supra*, 501 F.2d 639, 644; *Kohn v. Royall, Koegel & Wells* (2nd Cir. 1974), 496 F.2d 1094, 1098. *See also Handwerger v. Ginsburg* (2nd Cir. July 16, 1975), CCH Fed. Sec. L.Rep., Current Decisions ¶95,241, — F.2d

—, and *Seiffer v. Topsy's International, Inc.* (10th Cir. July 28, 1975), CCH Fed. Sec. L.Rep., Current Decisions ¶95,251, — F.2d —, in which the Tenth Circuit apparently adopts this three-prong test.

While on its face this test appears similar to that adopted by this Court in *Cohen* and in *Eisen IV*, the test has been applied strictly and mechanically, contrary to this Court's mandate. The "fundamental" requirement has been interpreted to require virtually a "reverse death-knell" situation whereby an action that would proceed anyway absent the order granting class action status is considered unappealable under Section 1291. Strict application of the requirement that the order be "separable from the merits" has virtually precluded any review of a district court's determination under Rule 23 that common questions predominate or that a class action is superior to other available methods of adjudication. *See generally General Motors Corp. v. City of New York, supra*, 501 F.2d 639, 656-661 (concurring opinion).[20]

Recently the Ninth Circuit changed its position, adopting a standard for finality under Section 1291 in the context of class action certification orders that is even stricter than the three-prong test which is used in the Second and Tenth Circuits. *Blackie v. Barrack*

[20]Although Petitioners do not advocate adoption of this test, the Ninth Circuit's dismissal of the appeal in the present actions was in error even if this test is applied since a reasonable application of the test, in view of the factors discussed in Part 1 *supra*, must lead to the conclusion that the District Court's order is a final decision under Section 1291.

(9th Cir. Sept. 25, 1975), (Nos. 74-2141, 2341, 2167, 2466 and 2648), __ F.2d __.[21] The Ninth Circuit has now explicitly rejected the three-prong test and has adopted the position of the Third, Sixth, and Seventh Circuits to the effect that class action certification orders are not final decisions appealable as a matter of right under Section 1291. *Katz v. Carte Blanche Corp.* (3d Cir. 1974), 496 F.2d 747, *cert. denied* (1974), 419 U.S. 885, 95 S.Ct. 152, 42 L.Ed.2d 125; *Thill Securities Corp. v. New York Stock Exchange* (7th Cir. 1972), 469 F.2d 14; and *Walsh v. City of Detroit* (6th Cir. 1969), 412 F.2d 226. This position is not only in conflict with that taken by the Second and Tenth Circuits but is directly contrary to this Court's directive in *Cohen* and *Eisen IV* since it virtually precludes the flexible determination of finality under Section 1291.[22]

The foregoing conflict must be resolved as it creates a pall of uncertainty which hangs over every class action, adversely affecting the district courts as well as the defendants in such actions. However, neither of the

[21]As indicated in footnote 14 *supra,* this decision is not yet final. Regardless of its present status, however, it does serve to emphasize the need for guidance from this Court since it is the second position on Section 1291 appealability of class action certification orders taken by the Ninth Circuit in five months.

[22]It should be noted that at least in the *Katz* decision, preclusion of review under Section 1291 may have been motivated by the Third Circuit's presumption that effective review of class action certification orders was available by interlocutory appeal under Section 1292(b) for substantive errors and by writ of mandamus under Section 1651(a) for procedural errors of a district court. However, the present actions most sharply demonstrate the ineffectiveness of such avenues of review.

foregoing positions should be adopted. Rather, *Eisen IV* should be reaffirmed by granting the writ sought herein. The only just and appropriate resolution of the question in cases such as the present actions is to grant appealability of class action certification orders as a matter of right under Section 1291. This was the position taken by the Second Circuit in the cases preceding *Eisen IV, see Herbst v. International Telephone & Telegraph Corp.* (2nd Cir. 1974), 495 F.2d 1308, and *Eisen v. Carlisle & Jacquelin* (2nd Cir. 1973), 479 F.2d 105 (*Eisen III*), *vacated on other grounds* (1974), 417 U.S. 156, 94 S.Ct. 2140, 40 L.Ed.2d 732 (*Eisen IV*), and it is the position mandated by the considerations present in the instant actions. As was recognized in *Eisen III,*

> "[a]n order sustaining a class action allegation clearly involves issues 'fundamental to the further conduct of the case;' (see Gillespie v. United States Steel Corp., 379 U.S. 148, 85 S.Ct. 308, 13 L.Ed.2d 199 (1964); Larson v. Domestic and Foreign Commerce Corp., 337 U.S. 682, 69 S.Ct. 1457, 93 L.Ed. 1628 (1949); United States v. General Motors Corp., 323 U.S. 373, 65 S.Ct. 357, 89 L.Ed. 311 (1945)); the order is also separable from the merits of the case; and irreparable harm to a defendant in terms of time and money spent in defending a huge class action when an appellate court may years later decide such an action does not conform to the requirements of Rule 23, is evident." 479 F.2d 1005, 1007 n. 1.

Conclusion.

For the foregoing reasons, a writ of certiorari should issue to review and to reverse the order of the United States Court of Appeals for the Ninth Circuit.

Dated: October 6, 1975.

Respectfully submitted,

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APPENDIX.

The Petitioners in *Touche Ross & Co., et al., v. Michael Fabrikant and Milton Binswanger* are as follows:

Touche Ross & Co.
H. Wilkins Crosby
William W. Fox
Goldman, Sachs & Co. and certain other "Underwriter Petitioners"
Philip Hampton
Dirk C. Kok, Jr.
Robert M. Overall
Philip D. Reed
Victor J. Schulman
Edwin Singer
Thomas W. Smith
Walter N. Thayer
John L. Weinberg
James G. Wilson
Union Bank

The Petitioners in *Touche Ross & Co., et al., v. Penn Mart Realty Co.* are as follows:

Touche Ross & Co.
H. Wilkins Crosby
William W. Fox
Philip Hampton
Dirk C. Kok, Jr.
Robert M. Overall
Philip D. Reed
Victor J. Schulman
Edwin Singer
Thomas W. Smith
Walter N. Thayer
John L. Weinberg
Union Bank

Order.

United States Court of Appeals, for the Ninth Circuit.

Michael Fabrikant and Milton Binswanger, Plaintiffs-Appellees, v. Robert G. Stewart, et al., Defendants-Appellants. No. 74-3435, No. 74-3437.

Penn Mart Realty Company, Plaintiff-Appellee, v. United States Financial, Inc., et al., Defendants-Appellants. No. 74-3436.

Touche Ross & Co., et al., Petitioners, v. The Honorable Howard B. Turrentine, United States District Judge for the Southern District of California, Respondent. No. 75-1496.

Before: BROWNING and CHOY, Circuit Judges.

After due consideration, the appeals in Nos. 74-3435, 74-3436 and 74-3437 are dismissed. *Eisen v. Carlisle & Jacquelin,* 417 U.S. 156, 171-72 (1974); *General Motors Corp. v. City of New York,* 501 F.2d 639 (2d Cir. 1974).

The petition for mandamus or prohibition or other relief in No. 75-1496 is denied. *Cf. Gold Strike Stamp Co. v. Christensen,* 436 F.2d 791, 791-94 n. 2 (10th Cir. 1970).

Filed: May 19, 1975.

Order.

United States Court of Appeals, for the Ninth Circuit.

Michael Fabrikant and Milton Binswanger, Plaintiffs-Appellees, v. Robert G. Stewart, et al., Defendants-Appellants. No. 74-3435, No. 74-3437.

Penn Mart Realty Company, Plaintiff-Appellee, v. United States Financial, Inc., et al., Defendants-Appellants. No. 74-3436.

Touche Ross & Co., et al., Petitioners, v. United States District Court, Southern District of California, Respondent. No. 74-1496.

Before: BROWNING and CHOY, Circuit Judges.

The panel as constituted in the above case has voted to deny the petition for rehearing and to reject the suggestion for a rehearing in banc.

The full court has been advised of the suggestion for in banc rehearing, and no judge of the court has requested a vote on the suggestion for rehearing in banc. F.R.A.P. 35(b).

The petition for rehearing is denied and the suggestion for a rehearing in banc is rejected.

Filed: July 9, 1975.

Order Designating Class Actions.

United States District Court, Southern District of California.

In re U.S. Financial Securities Litigation, MDL. No. 161.

Penn Mart Realty Company, Plaintiff, v. United States Financial, Inc., et al., Defendants. Civil No. 74-281-T.

Michael Fabrikant and Milton Binswanger, Plaintiffs, v. Robert G. Stewart, et al., Defendants. Civil No. 74-282-T.

Michael Fabrikant and Milton Binswanger, Plaintiffs, v. Robert G. Stewart, et al., Defendants. Civil No. 74-283-T.

TURRENTINE, District Judge.

BACKGROUND

This Order is made in response to requests for class designations in the U.S. Financial Securities Litigation.

U.S. Financial was initially incorporated in 1962 and thereafter engaged directly or through subsidiaries in the business of designing, producing, financing, insuring, and selling residential and commercial land and structures. Its securities were first listed on the New York Stock Exchange in December 1970. In April 1971, U.S.F. made a $35,000,000 public offering of 5½% Convertible Subordinated Debentures due April 1, 1991, underwritten by Goldman, Sachs & Co. Simultaneously certain U.S.F. shareholders made a public offering of 256,171 shares of U.S.F. Common Stock through underwriters represented by Goldman, Sachs & Co.

On October 16, 1972, the N.Y.S.E. halted trading in U.S.F. securities for a two week period after receiving copies of correspondence between U.S.F. and the Securities and Exchange Commission regarding the manner in which certain transactions had been accounted for in U.S.F.'s annual report for 1971. On December 5, 1972, the S.E.C. issued an order suspending trading in U.S.F. securities, and on July 23, 1973, U.S.F. filed a petition for an arrangement under Chapter XI of the Federal Bankruptcy Act in the United States District Court for the Southern District of California. Reorganization proceedings are in progress.

A number of securities fraud actions have been filed. Typically, U.S.F., its officers and directors, Goldman, Sachs & Co. and other underwriters, the accountants Touche, Ross & Co., and Union Bank have been named as defendants. The plaintiffs in these actions allege that U.S.F. engaged in a continuing scheme of creating sham transactions to create sham profits, which were publicly reported in registration statements, prospectuses, forms filed with the S.E.C., and press releases. The following description of these transactions has been given:

> U.S. Financial held many pieces of real estate. Subsidiary firms were either formed by individuals connected with U.S. Financial, or previously existing firms or individuals were brought into the family of firms associating with U.S. Financial. Pieces of real estate were 'sold' to the subsidiary firms and notes were given to U.S. Financial so that U.S. Financial could add an account receivable to its balance sheet. The subsidiaries were actually to only hold the properties until U.S. Financial could sell them. If cash were involved, arrangements were made to supply the 'buyers' with

enough cash so they could, in turn, transfer the money back to U.S. Financial. Secret agreements were made with the operators of the subsidiary firm to the effect that they would be reimbursed for any losses they incurred while holding the properties for U.S. Financial. If the subsidiary firm was scheduled to make a payment to U.S. Financial on the note, secret loans would be given to the subsidiary either directly by persons at U.S. Financial or indirectly through another subsidiary firm. These loan proceeds would then be fed back to U.S. Financial which would then book the receipt of the payment. A definite, circular flow of money created the illusion that U.S. Financial was selling large pieces of real estate for enormous profits. This illusion was created to obtain bank loans and to increase the value of the stock of U.S. Financial.[1]

Twelve of the security holder actions have been transferred to the Southern District of California for consolidated pretrial proceedings pursuant to 28 U.S.C. § 1407. Designations as class actions under Rule 23 (b)(3) have been requested in two of these actions; Penn Mart Realty v. U.S. Financial, (74-281-T) and Michael Fabrikant and Milton Binswanger v. Robert G. Stewart (74-282-T and 74-283-T).[2] The *Penn*

[1]Affidavit of Assistant U.S. Attorney David P. Curnow, appended to Amicus Curiae for the United States, submitted with respect to motions involving U.S. Financial Litigation before Judicial Panel on Multi-District Litigation.

[2]Fabrikant filed two separate actions based on different sections of the 1933 and 1934 Securities Acts. Binswanger subsequently moved to intervene in the second Fabrikant action. On August 21, 1974, a consolidated, amended complaint was filed for both cases naming both Fabrikant and Binswanger as plaintiffs. Since these actions are now identical they will be treated as one action for the purposes of this order.

Mart plaintiff proposes to represent a class of common stock purchasers who purchased between January 1. 1970, and December 5, 1972. The *Fabrikant* plaintiffs propose to represent a class consisting of purchasers of the 5½% Convertible Subordinated Debentures between April 1, 1971, and November 27, 1972.[3] The exact number of securities purchasers who fall within the ambit of these classes in unknown. It is alleged that there are "thousands" of debenture purchasers. There are approximately 4,000 holders of the common stock, but the number of persons who purchased common stock during the class period must be appreciably larger. The question of numbers will be clarified shortly because the defendant U.S.F. has consented to the proposed class designations in both actions and has agreed to identify the class members and mail notice, as to the actions against U.S.F. only, on September 20, 1974. No other defendant has consented to the class designations.

The request for a class designation in *Penn Mart*, which involves claims under Section 10(b) of the 1934 Securities Exchange Act and Rule 10b-5, will be considered first. This discussion will apply to the Section 10(b) and Rule 10b-5 claims in *Fabrikant* as well. It will then be necessary to consider the effect on the class designation of the additional claims raised in the *Fabrikant* action, particularly the claims under Section 11 of the 1933 Securities and Exchange Act.

[3]November 27, 1972, is the date trading was suspended by the N.Y.S.E. December 5, 1972, is the date trading was suspended by the S.E.C.

PENN MART REALTY

Initially the Court must decide pursuant to Rule 23(b)(3) whether or not a class action is superior to other available methods for the fair and efficient adjudication of the controversy and, pursuant to Rule 23 (a)(1), whether the class is so numerous that joinder of all members is impracticable. Because the number of common stock shareholders in Penn Mart exceeds 4,000, it appears that a class action is not only the most efficient, but also the only practical way in which the Court can assure representation of all possible plaintiffs.[4]

The significant question in *Penn Mart*, therefore, is whether "the questions of law or fact common to the members of the class predominate over any questions affecting only individual members." Fed.R.Civ.P. 23(b)(3). Additionally, it must be determined whether the plaintiff is a proper class representative. Fed.R.Civ. P. 23(a)(3) and (4).

1. *Common Questions of Law or Fact*

The most serious question of commonality of law or fact pertains to reliance,[5] which will be discussed below. But first, it should be noted that a "common core" of facts may be provided by the "common nucleus of operative facts" which are necessary to prove a

[4]The defendants assert there may be as many as 65,000 common stock purchasers, and that this number would result in problems of manageability. However, class actions of this size have not been deemed infeasible. Grad v. Memorex, 61 F.R.D. 88 (N.D.Cal. 1973).

[5]The defendants argue that damages also raise predominately individual questions of fact. This contention has been uniformly rejected in securities fraud cases. Grad v. Memorex, 61 F.R.D. 88 (N.D.Cal. 1973); Entin v. Barg, 60 F.R.D. 108 (E.D.Pa. 1973); and Herbst v. Able, 47 F.R.D. 11 (S.D.N.Y. 1969).

10b-5 violation. Entin v. Barg, 60 F.R.D. 108, 113 (E.D.Pa. 1973), and Green v. Wolf Corp., 406 F.2d 291 (2d Cir. 1968).

The language of Rule 10b-5(a) and (c) makes it unlawful "to employ any device, scheme or artifice to defraud" or "to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." Under this language the relevant inquiry is the existence of a broad course of fraudulent conduct. Such a course of conduct has been alleged in this action:

> [T]he Insider Defendants, acting alone or in concert with the other defendants, conspired together, acted and aided and abetted each other to artificially inflate the reported earnings and assets of U.S.F for the purpose of their own personal gain and of misleading the shareholders of U.S.F. and to artificially inflate the market price of the securities of U.S.F. (¶28, Amended Complaint).

The complaint alleges that all of the U.S.F. real estate transactions followed a familiar pattern:

> In 1970 and 1971, properties owned by U.S.F. or its subsidiaries were sold not in arm's length sales, but rather to nominees selected by defendants R. H. Walter and Halverson. Although the sales were carefully structured to appear as arm's length transactions, in each case no risk passed to the alleged purchaser. The terms of the transaction were determined solely by the Insider Defendants, and the Insider Defendants caused U.S.F. to provide, either directly or indirectly, the funds necessary to buy its properties. In connection with each such sale, U.S.F. reported income to the shareholders

and to the public at large through U.S.F.'s financial statements, its forms filed with the S.E.C. and in press releases. (¶30, Amended Complaint).

The Court concludes that these allegations provide a common issue of fact for all class members. The alleged real estate transactions are separate, but taken together they form one of the elements of a 10(b) and 10b-5 action, a "course of business which operates or would operate as a fraud or deceit on any person." Proof of this element is relevant to the claim of each class member, regardless of whether there are differences in reliance or damages.

2. *Reliance*

The real issue that presents possible individual questions of fact which militate against the formation of a class extending over the proposed thirty-four month period is the question of reliance, the problem of whether "[t]here was material variation in the representations made or in the kinds or degrees of reliance by the persons to whom they were addressed." Advisory Committee's Notes, Proposed Rules of Civil Procedure, 39 F.R.D. 69, 103 (1966).

The defendants argue there is no commonality of fact because the misrepresentations in this case are not similar, but disparate. The complaint is based on an undisclosed number of statements by the defendants "through U.S.F.'s financial statements, its forms filed with the S.E.C. and in press releases." The misrepresentations related to the financing of a large number of different real estate transactions occurring in 1970-1971. A cursory review of the complaint indicates that the alleged transactions fall into at least nine or ten unre-

lated groups. More are likely to be disclosed as discovery progresses. Problems in the similarity of misrepresentations and reliance of shareholders thereon arise because it is unclear that misrepresentations made at any given time reached all stockholders, and because stockholders purchasing at different times were subjected to different misrepresentations.

Even prior to the adoption of the 1966 revision of Rule 23, it was unnecessary to show that all investors relied on the same document. Thus, in Harris v. Palm Springs Alpine Estates, Inc., 329 F.2d 909 (9th Cir. 1964), the Ninth Circuit rejected an argument that various investors stood in different positions with respect to the representations made to them, and held it was sufficient to maintain the class if the complaint alleged "a common course of conduct over the entire period, directed against all investors, generally relied upon, and violating common statutory provisions." Harris v. Palm Springs Alpine Estates, Inc., 329 F.2d 909, 914 (9th Cir. 1964). *Harris* is a somewhat unsatisfactory signpost for the instant litigation because, although it clarifies that all investors need not rely on one document, it does not indicate how much variation in misrepresentations and reliance thereon is possible before commonality of fact is destroyed.

Fischer v. Kletz, 41 F.R.D. 377 (S.D.N.Y. 1966), picked up the *Harris* "common course of conduct" theory and stated that there is not a material variation if the financial statements are "interrelated, interdependent, and cumulative." The Court illlustrated with an often quoted simile:

> To be sure, we are not dealing here with a single alleged fraudulent misrepresentation or the issuance of a single document containing several al-

> leged misrepresentations. Like standing dominoes, however, one misrepresentation in a financial statement can cause subsequent statements to fall into inaccuracy and distortion when considered by themselves or compared with previous statements. Fischer v. Kletz, 41 F.R.D. 377, 381 (S.D.N.Y. 1966).

But as in *Harris,* the facts given in *Kletz* do not indicate the amount of variation in misrepresentation and reliance that will be tolerated. A subsequent case, Green v. Wolf Corporation, 406 F.2d 291 (2d Cir. 1968), indicated that a substantially similar reiteration of the same facts is required. In that case there were three prospectuses issued over a two year period. They differed with respect to various minutia and not all of the allegations of the plaintiff applied to all of the prospectuses. But some representations were the same and were repeated in each prospectus.

This Court perceives that the *Harris* and *Kletz* cases pertain to a situation in which the same or similar misrepresentations are reiterated throughout a series of documents. In such cases there is commonality of reliance because each investor is in essence relying on the same misrepresentation regardless of which document he consults. Such a theory is reasonable, but it is stretched to the breaking point in this case because it appears that there are many different transactions reported in different statements. The plaintiff has not alleged the same or similar misrepresentation was made in each document. However, it is unnecessary to reject a class designation at this time because of the possible inadequacy of this theory on the facts of this case. Two other reliance concepts have emerged which make a class action feasible.

First, some courts have indicated that in fraud cases the investor's reliance is based, not so much on particular misrepresentations, as on an artificially inflated price which may be the result of a series of misrepresentations. This theory has found its most explicit exposition in Grad v. Memorex, 61 F.R.D. 88 (N.D.Cal. 1973), in which the class period from August 1970 to April 1971 was punctuated by differing misrepresentations in S.E.C. filings and in news releases.

> [W]hile some sort of reliance on the part of the plaintiff still must be proved, it appears that reliance of the actual, subjective, individual nature necessary in the classical fraud case would unnecessarily encumber large 10b-5 actions and thereby thwart the Congressional interest in providing a means by which investors may recover against market manipulators in federal court. Grad v. Memorex, 61 F.R.D. 88 at 99 (N.D.Cal.1973).
>
> . . .
>
> In recent years a more realistic definition of the reliance requirement has evolved, the use of which permits huge securities cases to proceed under Rule 23(b)(3), yet assures fairness to the defendants. By use of an objective standard of reliance, focusing on a "causal nexus" between the alleged misstatements and an inflated price upon which plaintiffs relied, the court (and jury) is freed from the overwhelming task of examining the subjective intent of each class member in his decision with respect to his stock. Id. at 100.
>
> . . .
>
> If it is demonstrated that the Memorex documents materially misrepresented the financial status of the corporation and that the market responded

> thereto in a manner that the stock can be said to have been "inflated," and that it was reasonable for an investor to rely theron, then a sufficient showing of a causal connection between the misrepresentations and the purchases by class members will have been made. *Id.* at 101.

Similarly, in Siegel v. Realty Equities Corporation of New York, 54 F.R.D. 420 (S.D.N.Y.1972), the class action was permitted to proceed on the theory that the market price of the R.E.C. stock had been artificially inflated. The defendants contended that there was no proof of reliance because the plaintiff could not ascertain specifically which of the twelve documents in question he relied on. However, the Court accepted the argument that reliance might be based on the artificially inflated market price alone:

> It appears to this Court . . . that if plaintiff at trial can sustain the difficult burden of proving defendants issued false statements concerning their financial condition and paid dividends in contravention of their agreements with creditors, and that these activities caused the market price of REC securities to be inflated, a jury might find it reasonably foreseeable that such inflated prices would induce the public to purchase REC stock, and subsequently to suffer damages when the misrepresentations were uncovered. Siegel v. Realty Equities Corporation of New York, 54 F.R.D. 420, 425 (S.D.N.Y.1972).

The artificially inflated market price theory makes it unnecessary to prove that each investor relied on the same misrepresentation. It is sufficient to show that there were different misrepresentations which were a

part of a common scheme to manipulate the price of the stock. The facts of the instant case fit this theory. It may develop that there is some variance between misrepresentations, but the misrepresentations taken as a whole appear part of an uninterrupted manipulation of the price over the alleged class period.

Second, the plaintiff may be able to proceed in this case on a theory of nondisclosure. Although defendants protest that the gravamen of the plaintiff's claim is one of misrepresentation, the court notes that the complaint has properly pleaded omission as well, and the court cannot determine at this point that it is impossible to proceed on this theory. Under the decisions in Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 92 S.Ct. 1456, 31 L.Ed.2d 741 (1972); Mills v. Electric Auto-Lite Co., 396 U.S. 375, 90 S.Ct. 616, 24 L.Ed.2d 593 (1970); Kohn v. American Metal Climax, Inc., 458 F.2d 255 (3d Cir. 1972) and Kahan v. Rosenstiel, 424 F.2d 161 (3d Cir.), cert. denied. 398 U.S. 950, 90 S.Ct. 1870, 26 L.Ed.2d 290 (1970), it is arguable that reliance is not an essential element of a claim for damages under Section 10(b) and Rule 10b-5, and only the materiality of the misrepresentation or omission need be proved. Recently a number of courts have indicated that a class designation will not be denied on the question of individual reliance where the cause of action can proceed on non-disclosure. Entin v. Barg, 60 F.R.D. 108, 111-112 (E.D.Pa.1973); In re Caesars Palace Securities Litigation, 360 F.Supp. 366, 399 (W.D.Mo.1973); In re Penn Central Securities Litigation, 347 F.Supp. 1327, 1344 (E.D.Pa. 1972).

The Court concludes that individual questions of reliance do not predominate. The plaintiff may pro-

ceed either on a theory of reliance of the class as a whole on an artificially inflated market price, or on a theory of non-disclosure.

3. *The Effect of White v. Abrams*

The plaintiffs also argue that the "flexible duty standard" recently adopted by the Ninth Circuit in White v. Abrams, 495 F.2d 724 (9th Cir. 1974), creates predominating individual issues of fact. The "flexible duty standard" replaces scienter or other state of mind concepts as an element in Section 10(b) actions. The Ninth Circuit provided the following yardstick for determining the extent of the duty owed:

> Without limiting the trial court from making additions or adaptations in a particular case, we feel the court should, in instructing on a defendant's duty under Rule 10b-5, require the jury to consider the relationship of the defendant to the plaintiff, the defendant's access to the information as compared to the plaintiff's access, the benefit that the defendant derives from the relationship, the defendant's awareness of whether the plaintiff was relying upon their relationship in making his investment decisions and the defendant's activity in initiating the securities transaction in question. White v. Abrams, 495 F.2d 724, 735 (9th Cir. 1974).

Defendants argue that the "flexible duty standard" renders this class action impracticable because it is necessary to evaluate the duty owed by each of the many defendants to each of the plaintiffs. Literally thousands of determinations of duty would be required.

Abrams does not destroy the class designation in this case for two reasons. First, the overall impact of

Abrams is to extend the range of liability in individual Section 10(b) actions. Negligent conduct, which has been rejected by some courts as the basis for a Section 10(b) claim, is now adequate in the Ninth Circuit to establish liability under certain circumstances. It would therefore be incongruous for *Abrams* to restrict the use of class actions, which are the primary vehicle by which the investing public may obtain a recovery for Section 10(b) and Rule 10b-5 violations. Second, it will be unnecessary for the trier of fact in this case to determine the duty of each defendant to each plaintiff. The great majority of plaintiffs are open market purchasers so that their relationship to each of the defendants is identical. The determination of the duty of each defendant to the class as a whole will be no more difficult than establishing the duty of each defendant to an individual plaintiff.

4. *Adequate Representation*

The defendants argue that Penn Mart Realty is inadequate as a class representative because the plaintiff purchased 100 shares on March 8 and 100 shares on May 16, 1972, near the end of the class period. It is contended that Penn Mart is not typical of the entire class because it could have relied only on those misrepresentations contemporaneous with its purchase. Furthermore, it is asserted that the plaintiff did not rely on any U.S.F. financial reports or prospectuses at all, but relied solely on the market price, Valueline surveys, and the advice of a broker. Defendants contend plaintiff will have no real interest in attempting to prove all misrepresentations in the wide range of the information issued by U.S.F. and reliance thereon. Purportedly a conflict would arise between the plaintiff

and earlier purchasers, because plaintiff would have no interest in pursuing earlier claims with equal vigor.

The Court rejects the defendants' contentions in light of the above discussion of reliance. If reliance is placed on the inflated market value of the stock, the situation of the plaintiff is not differentiated from that of other class members. The plaintiff has an interest in proving the entire alleged fraudulent course of conduct which resulted in an inflated price. As a practical matter, the attorney for the plaintiff has a very real interest in demonstrating that the inflated price extended over the entire class period because the success of the class as a whole will largely determine his remuneration. Other cases have held that the class representative may purchase at either the beginning or the end of the class period. In Fischer v. Kletz, *supra,* 41 F.R.D. 377 (S.D.N.Y. 1966), the representative purchased in the beginning of the class period and in Green v. Wolf, *supra,* 406 F.2d 291 (2d Cir. 1968) the representative purchased in the latter period of the class period.

5. *Class Designation*

Penn Mart is designated as a class action on behalf of all purchasers of the common stock of U.S.F. between January 1, 1970 and December 5, 1972, who either 1) were holders of such stock on December 5, 1972, or 2) sold such stock and were damaged by the wrongs alleged in the complaint. This initial designation is subject to change by the Court under the provisions of Rule 23(c)(4). For instance, as the litigation develops it may be appropriate to form subclasses. The registration statement and prospectus in April 1971, and an annual report in April 1972, may provide logical points of division. Also, any purchases of

blocks of stock as the result of direct negotiations with the defendants may present predominating individual questions of fact which are inappropriate to this class action.

The plaintiffs have asked the Court to explicitly exclude Section 11 and other claims from the *Penn Mart* class action. It is unnecessary to consider this question at this time because the *Penn Mart* complaint rests on Section 10(b) and Rule 10b-5 only. The Court will examine the matter at a later date should the plaintiff move to amend the complaint or bring in an intervenor to establish a claim under Section 11 or other Sections.

FABRIKANT

In addition to the Section 10(b) and Rule 10b-5 fraud claims, the *Fabrikant* action seeks to enforce liabilities arising under pendent common law claims, under Section 323 of the Trust Indenture Act of 1939 (15 U.S.C. § 77www), and under other Sections of the 1933 and 1934 Securities Acts, namely Sections 13(a), 18(a) and 20 of the 1934 Act (15 U.S.C. §§ 78m(a), 78r(a), and 78t) and Sections 11, 12 and 17 of the 1933 Act (15 U.S.C. §§ 77k, 77*l* and 77q.).

1. *Superiority of Class Action*

This action is not as obviously well adapted to class treatment as the *Penn Mart* action because it may involve fewer security holders and because several large debenture holders have filed separate actions (Nos. 74-384, 74-285 and 74-286). Defendants offer statistics to show that, as of April 1, 1973, 93% of the debentures were held in blocks of $20,000 or more and 83% were held in blocks of $100,000 or more by corpora-

tions, institutional investors, or brokers in their own or nominees' names. Purchasers of 29% of the debentures are already before the Court. Therefore the defendant argues that joinder is the superior method of proceeding because the debenture holders are sophisticated, institutional investors who have the monetary incentive and means to look after their own interests. Dolgow v. Anderson, 43 F.R.D. 472, 492 (E.D.N.Y. 1968). Denial of a class designation will not sound the "death knell" of the litigation.

A similar argument was made and rejected in Dorfman v. First Boston Corp., 62 F.R.D. 466 (E.D. Pa. 1973):

> Defendants make much of the fact that as of June 1, 1970, the date of the first interest payment, approximately 85% of the debentures were held in blocs of $25,000 or more, with 61% being held in blocs of $200,000 or more, and that the holdings of ten institutional investors accounted for 40% of all debentures outstanding at that time. (Affidavit of Carole E. Broderick, Esq.) Even assuming, which we do not, that a class action is appropriate *only* if the class is made up of small claimants, we are unable to draw any relevant conclusions from the figures before us. We cannot divine, for example, what portions of the institutional holding were only as of record for individuals and therefore cannot determine the size of the holdings of the beneficial owners of the Pennco debentures. It would be inappropriate to take the drastic step of denying class status on the basis of defendants' figures.

As the plaintiff in this action points out, if the average block were as large as $20,000, there would be over 1,650 purchasers, and one would conclude that there

are a large number of individual purchasers, composing a class so numerous that joinder of all the members is impracticable, regardless of the size of the individual claims.

2. *Common Issues of Law and Fact*

Our finding of commonality of questions of fact in the Section 10(b) and Rule 10b-5 action in *Penn Mart* applies with equal force to *Fabrikant*. However, in *Fabrikant* the defendants raise an additional argument that the Section 11 claims present a basically different legal claim involving different factual proof from the Section 10(b) and Rule 10b-5 claims.[6] Section 11 of the 1933 Act relates to misrepresentations and omissions in the registration statement, whereas Section 10 (b) of the 1934 act is broader and relates to all omissions and misrepresentations.

The main distinctions between the two sections have been set out in Unicorn Field, Inc. v. The Cannon Group, Inc., 60 F.R.D. 217 (S.D.N.Y. 1973):

> First, in a § 11 action, . . . recovery is limited to purchasers of shares covered by the defective registration statement. There is no such limitation in a §10(b) action; any open market purchaser would have standing to sue. Secondly, recovery under § 11 is limited to the difference between the actual purchase price of the shares (not exceeding the initial offering price) and the value of the shares at the time suit is brought or the proceeds

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[6]Defendants also object to the presence of claims under Section 17 of the 1933 Securities and Exchange Act and Section 323 of the Trust Indenture Act of 1939. Since the provisions of Section 17 are similar to Section 10(b) and the provisions of Section 323 are similar to Section 11, the Court discusses only the differences between Sections 10(b) and 11.

> received upon sale before or after commencement of suit. § 11(e). Third, the burden of proof in a § 11 action is far less onerous. With certain exceptions [the "due diligence" defenses] plaintiff need only demonstrate that the registration statement and prospectus were materially false and misleading and need not prove fraudulent intent on the part of the issuer. And, . . . reliance on the part of the purchaser is conclusively presumed. Although it is no longer necessary to prove reliance in a § 10(b) action where the gravamen is nondisclosure, . . . a showing of some causal nexus between the deception and the injury is still required.

The defendants have cited several cases for the proposition that Section 11 and Section 10(b) claims cannot be included in the same class action: Herbst v. Able, [1973 Transfer Binder] CCH Fed.Sec.L.Rep. ¶ 93,922 (S.D.N.Y. 1973); Unicorn Field, Inc. v. The Cannon Group, *supra,* 60 F.R.D. 217 (S.D.N.Y. 1973); Pearlman v. Gennaro, [1973 Transfer Binder] CCH Fed. Sec.L.Rep. ¶ 94,006 (S.D.N.Y. 1973); and Wolfson v. Solomon, 54 F.R.D. 584 (S.D.N.Y. 1972). However, a reading of these cases indicates that, although the claims were not included in one class, in every case they were handled as classes or subclasses which were to be included in the same trial. It is possible for the classes or subclasses to be composed of the same plaintiffs and counsel. The Court perceives there is no reason why these claims should not remain part of the same action. Their co-existence would not unduly complicate a trial because the broader Section 10(b) action encompasses the misrepresentations and omissions in the registration statement, which form the basis of the Section 11 action. As stated in Wolfson v. Solomon, *supra,*

54 F.R.D. 584 at (S.D.N.Y. 1972). "The Section 11 violation, if it exists, will be proved in the course of proving the Section 10(b) violation, if it exists." To avoid confusing the jury, the Section 11 claim including the "due diligence" defenses can be tried first; then the same jury may proceed with any additional facts, including reliance, which are relevant to the Section 10 (b) claim. Herbst v. Able, *supra* [1973 Transfer Binder] CCH Fed.Sec.L.Rep. ¶ 93,922 (S.D.N.Y. 1973).

The defendants also argue that the claim under Section 12 of the 1933 Act presents predominating individual questions of law and fact because the "weight of authority has construed the statute to permit suits by a buyer against his immediate seller only." *See,* e.g., DeMarco v. Edens, 390 F.2d 836 (2d Cir. 1968); Unicorn Field, Inc. v. The Cannon Group, *supra,* 60 F.R.D. 217 (S.D.N.Y. 1973). Insofar as this interpretation is correct, this section is inappropriate for class treatment. The common law fraud claims brought under pendent jurisdiction are also inappropriate because individual questions of law would predominate if it were necessary to canvass the law of every state in which a purchase of debentures was made.

3. *Adequate Representation*

Defendants argue that Binswanger and Fabrikant purchased at the beginning and end of the proposed class period and therefore are not typical of all class members claiming under Section 10(b) and Rule 10b-5. Binswanger purchased $40,000 worth of the debentures on April 1, 1971, and Fabrikant made purchases of $10,000 on September 29, 1972 and $10,000 on October 11, 1972. The same argument was tendered in

the *Penn Mart* case, and it is rejected for the same reasons given in the Court's discussion of *Penn Mart* as a class representative. If it is possible for the representative to purchase at either end of the class period, the plaintiffs' position here is even stronger because the representatives are located at each end of the period.

The defendants also contend that Binswanger and Fabrikant are improper representatives of a class with Section 11 claims, because there is a conflict between their roles as Section 11 and Section 10(b) representatives. The Court in Wolfson v. Solomon has previously analyzed and answered this argument:

> The defendants suggest that, in view of the easier proof required under a Section 11 claim, a common plaintiff who represents both classes would tend to proffer the easier proof under Section 11 and then rest upon his laurels, oblivious to the fate of the fraud class. I do not believe the argument to be persuasive for two reasons. First, there may be greater recovery under the antifraud sections where Section 11(e) does not apply; and second, it is unrealistic to think that the common lawyer for both classes will forget the fee implications of a greater recovery. While lawyers in these class suits are earning their keep as private Attorneys General, they are not seeking to minimize the recoveries which measure their fees. Wolfson v. Solomon, *supra,* 54 F.R.D. 584 at 589 (S.D.N.Y. 1972).

Binswanger appears to be an adequate Section 11 representative because he purchased at the time of the offering. Fabrikant is less sound as a representative of Section 11 claims because he may have purchased after

the issuance of U.S.F. of a "twelve month earning statement." Purchasers prior to such a statement need not prove reliance on the registration statement, but subsequent purchasers must prove reliance, which makes their case substantially more difficult. Section 11(a) [15 U.S.C. § 77k(a)]. Nevertheless, the Court will not reject Fabrikant at this time as a Section 11 representative for two reasons. First, it is argued by the plaintiffs that such a twelve month earning statement was never published, so that Fabrikant need not prove reliance and thus stands in the same position as all Section 11 claimants. Second, even if such a statement exists, Fabricant still must prove what is essential to the prestatement Section 11 claimants. He merely has the additional burden of proving actual reliance.

4. *Class Designation*

The *Fabrikant* actions are designated as a class action on behalf of all persons purchasing U.S. Financial 5½% Convertible Subordinated Debentures between April 1, 1971 and December 5, 1972. Milton Binswanger and Michael Fabrikant are the class representatives. This designation is provisional and the Court will delimit the extent of the class or create subclasses at a later date as necessary. Fed.R.Civ.P. 23(c)(4). For instance, it may appear appropriate to segregate Section 10(b) and Section 11 claims into separate classes, or to separate Section 11 claims into pre- and post-twelve month earning statement subclasses, should the existence of such a statement be proved. Section 12 claims as they may relate to actions by a buyer against his immediate seller, and common law claims, are excluded from the class action.

NOTICE

The *Penn Mart* and *Fabrikant* plaintiffs shall bear the cost of mailing notice.[7] Counsel for the plaintiffs shall forward drafts of the notices, which shall fulfill the requirements of Fed.R.Civ.P. 23(c)(2), to the Court for approval by September 20, 1974.

Filed: September 11, 1974.

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[7]Defendants have objected that Penn Mart Realty has not shown it can pay the cost of notice. The Court notes that counsel has represented that Penn Mart would pay for mailing of notice. The class designation is, of course, conditioned on payment of notice by plaintiffs.